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August 19, 2009

ASR Group

Primary Credit Analyst:
Paul Bradley, London (44) 20-7176-7054; paul_bradley@standardandpoors.com

Secondary Credit Analyst:
Lotfi Elbarhdadi, Paris (33) 1-4420-6730; lotfi_elbarhdadi@standardandpoors.com

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ASR Group

Major Rating Factors

Strengths:

- Strong competitive position
- Stabilizing and supportive ownership
- Sound, albeit weakened, capitalization

Operating Companies Covered By This Report
Financial Strength Rating
Local Currency
A/Negative/--

Weaknesses:

- Volatile operating performance
- Concentration in the mature Dutch market

Rationale

The ratings on operating entities ASR Levensverzekering N.V. and ASR Schadeverzekering N.V. (formerly Fortis ASR Levensverzekering N.V. and Fortis ASR Schadeverzekering N.V.) reflect their core status to the ASR Nederland Group (ASR). ASR enjoys a strong competitive position in The Netherlands, and Standard & Poor's Ratings Services views the Dutch state's current ownership of the group as stabilizing and supportive. A weakened capitalization and operating performance and a concentration in the mature Dutch market partly offset these credit strengths.

The two rated entities represent 65% of ASR's consolidated premiums. Their direct parent is the holding company ASR Nederland N.V. (not rated), formerly Fortis Insurance Netherlands. The Dutch government has owned ASR since Oct. 3, 2008, following the dismantlement of the Fortis group. Before that date, we based our ratings on the core status of these subsidiaries on that of the Fortis group.

In our view, the group's competitive position is strong, thanks to a diversified product range and distribution through generalist and niche brands. ASR holds a sound position in its home market, with an aggregate market share of 12% and a No. 4 position. ASR is a leading insurer in accident and health (A&H; No. 1) and property/casualty (P/C; No. 3). In life business, the group ranks No. 4 in individual life and No. 6 in pensions. Offsetting these strengths is business concentration in the highly competitive and mature Dutch market, and a mostly brokered distribution (accounting for 81% of premiums written).

We view state ownership as stabilizing in the current market environment, giving ASR time to establish itself as a stand-alone group and redefine its strategy after it was split off from Fortis group. However, we do not expect state ownership to become a competitive strength for ASR, but we do reflect it in our assessment of financial flexibility since we expect the state to allow earnings retention at ASR.

We believe that risk-based capital adequacy suffered in the light of adverse investment market conditions during 2008. An exceptional dividend to Fortis group in 2007 exposed net assets to market volatility, due to excessive reliance on items such as unrealized capital gains and present value of future profits. However, capital adequacy remains good, albeit at lower levels than we usually expect for the current ratings. Capitalization is also supported by prudent claims reserving and hedging strategies.

Underlying operating performance is currently under pressure, but we believe it will be strong in the long term. Net earnings dropped significantly to negative €640 million in 2008 from a positive €889 million in 2007. However, long-term underlying performance remains sound: over the past five years, the combined ratio has averaged 95% and life new business margin has averaged 1.8%. However, although the fall in net earnings came mostly from depressed markets and one-off effects, it indicated some intrinsic weaknesses such as a high sensitivity to movements in interest rates and a relatively high cost base.

Outlook

The negative outlook reflects the challenges that ASR could face in restoring its capitalization and operating performance to levels supportive of the current ratings.

We expect gross premium volumes to move in line with the overall insurance market average with declining volumes in life and P&C and a positive trend in A&H. Following a drop in gross premium volumes in 2009 as a result of the disentanglement from Fortis (including Fortis Bank), ASR is expected to restore its premium volumes in 2010 within the bancassurance and mortgage segments of the insurance market thanks to new banking partnerships.

We expect operating performance in 2009 to recover because of sound underwriting in A&H and the absence of the one-off items that depressed year-end 2008 earnings. We expect the net non-life combined ratio to remain lower than 95% and life new business margin to increase to more than 1% in 2009 and 1.5% in 2010. In addition, we expect ASR to favor earnings retention to improve capital adequacy to levels in line with the current ratings by year-end 2010.

We may lower the ratings within the next 24 months if we believe that ASR may not meet the above targets. We may also downgrade ASR if we believe its financial strength is threatened by a change in ownership, a change in its risk profile, an unclear strategy, or further structured asset losses.

We may revise the outlook to stable by 2010 if ASR exceeds all of the above business and financial expectations.

Corporate Profile

ASR Nederland N.V. (ASR N.V.) is the new name of Fortis Insurance Netherlands. Since Oct. 3, 2008, ASR N.V. has been owned by the Dutch government following the dismantlement of Fortis Group.

ASR N.V. acts as the consolidation vehicle for all the former Dutch insurance operations of Fortis. ASR N.V.'s operations are organized into two generalist insurers, the rated entities ASR Levensverzekering N.V. and ASR Schadeverzekering N.V., and six other specialized insurers/brands: De Amersfoortse (A&H), Falcon Leven (unit-linked business), Europeesche (travel insurance), Ardanta (funeral insurance), Ditzo (Direct Insurance), and ASR Vastgoed.

In 2008, ASR recorded €5.8 billion gross inflows. Distribution is mostly brokerage-oriented (81%), with the remainder being distributed directly (14%) and through bancassurance (5%). ASR's product profile comprises individual life (42%), group life (19%), A&H (22%), and P/C (17%).

Competitive Position: Strong With Diversified Product Range

Table 1

ASR Group/Business Statistics			
(Mil. €)	2008	2007	2006
Non-life gross premiums written	2,268	2,110	1,939
Annual change (%)	7.5	8.8	--
Life gross premiums written	3,491	3,108	3,437
Annual change (%)	12.3	(9.6)	
Total gross premiums written	5,759	5,218	5,376
Annual change (%)	10.4	(2.9)	--

In our view, ASR's competitive position is strong, thanks to a diversified product range and a presence through general and niche brands. Offsetting this is a concentration of business in the highly competitive and mature Dutch market. A changing environment for ASR, as a consequence of its disentanglement from the Fortis Group, should lead ASR to focus more on restructuring and enhancing internal processes to maintain the persistency of its existing portfolio, rather than on fierce competition for premium growth. We expect ASR to maintain its premium volumes through new local partnerships, however.

Historic

We believe ASR boasts leading positions in its home market, although the challenging market conditions and stiff competition from other leading insurers have led to a slight decline in market share over the past five years, mostly within individual life business. ASR's home market is highly concentrated and mature, particularly within the individual life and P/C sectors, where total growth ranges from nil to decreasing over the past three years. The company's approach in providing a full product range, distributed using a multi-brand approach including long-established niche players, as well as new internet channels, somewhat mitigates the impact of such a challenging market environment. Despite the challenging market conditions in 2008, premiums grew by 10%, supported by growth both in the life and non-life segments. While life business recorded good growth over the past two years (+1.6%), such growth has been mainly dependent on large single premium group business, which is not recurring. P/C stagnated during 2008, reflecting the dynamics of a mature market. The slight growth in the non-life segment of the market was underpinned by the growth in A&H, where ASR holds a leading position. The disentanglement from Fortis Group during 2008 resulted in ASR losing its exclusive distribution agreement with the outlets of Fortis Bank Netherlands (representing 5% of premiums). We believe that the loss of this agreement will encumber the new mortgage insurance business volumes due to the absence of business originated through Fortis Bank Netherlands. However, we expect ASR to mitigate the impact of the loss of this agreement by entering into new banking partnerships.

Prospective

We expect gross premiums and new business volumes in 2009 to remain stable or to increase slightly. The current market environment and the specific Dutch insurance market environment should result in stable volumes in life business at ASR. Fierce competition in P/C should result in stagnating premiums, while we expect a positive trend within the A&H segment. We expect ASR to focus on organic growth and maintain the persistency of its existing business. We expect the disentanglement from Fortis Group to adversely weigh on ASR's goal of increasing bancassurance distribution and premium volumes for mortgage insurance. However, we expect ASR to replace premium volumes through new banking partnerships.

Management And Strategy: Capable Management Team, But Future Strategic Direction Remains Uncertain

ASR enjoys continuity in its management structure, and management is focusing on markets and product lines that it already knows well. The disentanglement from Fortis Group poses real challenges in our opinion, but the state ownership, despite being considered only temporary, provides ASR with the stability and time to redefine its strategy as a stand-alone insurance group. We believe that uncertainties in financial management and future strategic direction persist, however.

Strategy

ASR aims to attain a fully stand-alone structure following its disentanglement from Fortis Group within one year while maintaining its business profile and developing alternative distribution partnerships. The challenge in the coming months will be to implement a new stand-alone strategy, excluding the synergies and strategic thinking developed under the ownership of the Fortis Group. Although ASR previously functioned as a stand-alone entity, its strategy was influenced by the broader Fortis Group strategy that was transposed to all entities in recent years. The disentanglement has a material impact on ASR's strategy in our view. We expect ASR to seek new distribution channels to offset the loss of business from the annulment of the exclusive distribution agreement with Fortis Bank outlets in The Netherlands.

Operational management

ASR operates as a stand-alone entity, but previously had significant links with Fortis, mostly in the areas of risk management, reinsurance, human resources, and information technology. We do not expect the disentanglement from Fortis to impede the management of the business due to the continuity in the management team. We expect ASR to rationalize its cost base in order to mitigate the impact of synergies lost as a result of its separation from the Fortis Group. In the meantime, ASR is ensuring continuity in the above functions through temporary service contracts.

The role of the Dutch government is largely limited to ownership. The government is not involved in the day-to-day management of ASR. This ownership is a stabilizing factor that is anticipated to last for two to five years with the aim of creating a financially stable, viable, and independent entity.

Financial management

Because of the current transformation that ASR is undergoing, it is too early to set financial targets. The disentanglement from the Fortis Group also affects financial management as the group was previously managed as a financial conglomerate, assuming diversification between the banking and insurance businesses. This led to a groupwide capital management framework based on Fortis Group standards. In the coming months, we expect ASR to set up new capital and risk management standards as a stand-alone entity. In the meantime, ASR monitors solvency using the Dutch regulator's standard for financial strength, but has set no explicit minimum coverage ratio.

Enterprise Risk Management: Adequate, But Subject To Gradual Change To Reflect Stand-Alone Status

We view enterprise risk management (ERM) processes at ASR as adequate, mostly reflecting the processes put in place under the former Fortis Insurance division. We do not expect ASR to experience losses outside of normal ranges from traditional risk areas. This assessment is supported by strong controls for reserving risks, and adequate controls for the remaining risk areas. The disentanglement from Fortis Group means that ASR must develop its own risk management and capital management standards under a stand-alone structure, particularly with regard to asset and liability management, reinsurance optimization, catastrophe risk management, and modeling in general. Our ERM assessment of adequate is also supported by our expectation that ASR will continue to apply existing risk management practices, while gradually adapting them in light of its new stand-alone structure.

Market and life insurance risks are the most important risks at ASR, and credit and non-life risks are also important. The importance of ERM to the ratings is moderate.

We view ASR's risk management culture as adequate. As part of the roll-out of Fortis Group's risk management policies across its operating entities, ASR implemented risk committees, appointed business risk managers, and increasingly embedded risk management practices within its business units. ASR's risk management structure used local specialists in advising on local risk management, which is likely to help ensure the continuity of these practices despite its disentanglement from the Fortis Group.

ASR has adequate asset-liability management (ALM) practices, supported by the good ALM modeling and reporting implemented in recent years. ALM tools are used to monitor the business through value- and earnings-at-risk measures, and used as decision-making tools for the mitigation of market and interest rate risks (for example, when designing hedging strategies). Strategic asset allocation is defined and regularly monitored thanks to stochastic ALM tools used within a risk-return framework.

Operational risks, particularly those arising from the disentanglement from Fortis Group, appear to be adequately managed, through business continuity processes started in October 2008.

With regard to risk modeling, ASR previously relied to a large extent on the Fortis Insurance Group, particularly in the areas of reinsurance optimization, catastrophe risk modeling, market consistent valuation of liabilities, finance, investment management, and capital measurement. Such reliance represents a temporary weakness in risk management processes. Nevertheless, we believe that the historical involvement of ASR personnel in these processes should help gradually migrate toward an independent risk management framework within the next two years.

Accounting: Prepared Under IFRS

ASR's accounts are prepared under International Financial Reporting Standards (IFRS). The audit opinion is unqualified, and the accounting policies do not raise any rating concerns. Our analysis of capitalization is based on ASR's consolidated accounts, including data from the unrated niche players in The Netherlands. We have used supplementary embedded value (EV) information as part of our earnings and capital analysis.

Operating Performance: Consistently Strong

Table 2

ASR Group/Operating Statistics

(Mil. €)	2008	2007	2006
Net income	(633)	905	629

Table 2

ASR Group/Operating Statistics (cont.)			
ROE (%)	(43.2)	31.7	21.5
Net loss ratio (%)	62.1	59.2	55.2
Net expense ratio (%)	32	33.7	35.4
Net combined ratio (%)	94.1	92.9	90.5

Operating performance is strong, supported by strong underwriting performance in non-life business and good underlying profitability in life business over the long term. We believe that the relatively high sensitivity of life earnings to interest rate movement offsets these factors. A high cost base exacerbates the sensitivity of profitability in the life and non-life segments.

Historical

ASR boasts strong underlying profitability through the cycle both within the life and non-life segments. However, we believe that adverse investment market conditions and asset impairments hindered ASR's earnings in 2008. Non-life underwriting performance also worsened in 2008, albeit to a lesser extent, as reflected by an increase of 1.3% in the net combined ratio.

Net earnings in 2008 fell significantly to negative €640 million from €889 million, translating into a return on equity (ROE) of negative 43% in 2008 (32% in 2007) and lowering the three-year average ROE to a low 3% for the period 2006 to 2008. This is mostly due to lower realized gains compared with 2007, however, and represents a substantial fall in the market value of investments and the depreciation of the structured credit portfolio. In addition, the one-off cost impact of ASR's intention to comply with its commitment to ensure greater transparency on unit-linked charges and to indemnify itself against subsequent claims had an adverse impact on net earnings during 2008.

Owing to its correlation with the performance of investment markets, life profitability decreased significantly in 2008. The performance of the life business is particularly sensitive to interest rate movements due to the interest rate guarantees within certain product lines and the impact of equity market movements on product charges/fees for unit-linked business. Favorable mortality and morbidity experience counterbalanced the adverse impact of investment market conditions to some extent. Excluding the adverse impact of investment market conditions, new business margins and the overall life business performance in 2008 remained good, albeit still hampered by a high cost base and a business mix skewed toward less profitable traditional individual and group business.

The non-life segment has been delivering strong profits, albeit declining, over the past five years, as evidenced by an average net combined ratio of 95%. This has been achieved due mostly to A&H, which continues to be the key driver for results. ASR's strong business position in A&H combined with a focus on improving the underwriting profitability and relatively low allocated expenses led to this line of business providing the majority of the total non-life operating profit. Historically, P/C business has been more pressured than A&H, with P/C technical results showing a significant fall in 2008. High acquisition costs have traditionally impeded the performance of the P/C business, reflecting the costs associated with the broker distribution channel, as well as the relatively high administrative and claims handling costs. ASR's focus on disciplined underwriting and claims resulted in strong underwriting performance, which generally more than offset the impact of high expenses. In 2008, however, the heightened competition in the Dutch market, particularly in motor, led to a deterioration in the combined ratio.

Prospective

We expect operating performance in 2009 to recover to stronger levels, supported by sound underwriting in A&H. We expect this to help maintain the overall net non-life combined ratio at lower than 95% and we also expect a recovery in life new business margin to above 1% in 2009. Excluding investment variances, we expect an operating return on embedded value to approach 8% in 2009.

Investments: Strong Credit Quality But With Significant Exposure To Interest Rate Risk

We view ASR's investment strategy as strong with the absence of significant concentrations and the use of interest rate and equity hedging instruments. The credit quality of the bond portfolio is strong. Offsetting factors include a high exposure to interest rate risk and a high aggregate exposure to market risk through investments in real estate, mortgages, equities, corporate bonds and structured assets.

Credit risk

We view the credit quality of ASR's bond portfolio as strong with an average rating of 'A'. ASR's exposure to Tier 1 banking instruments constituted 4% of invested assets as at the 2008 year-end (€1.3 billion).

Market risk

As evidenced by the impact on the balance sheet of decreasing equity markets and widening credit spreads during 2008, ASR is significantly exposed to changes in investment market conditions. ASR has a relatively high aggregate exposure to real estate and mortgages, which exposes it to a downturn in the property market. Equity investments remain relatively manageable (4% of investments), following relatively recent equity de-risking undertaken. In addition, ASR mitigates its equity market risk exposure through put options covering 25% of the portfolio. ASR also generally holds its bond portfolios to maturity, limiting the cash impact of widening credit spreads.

Interest rate risk

As at the end of 2008, interest rate risk represented one of the key investment risks for ASR and in particular the downside risk due to interest rate guarantees. This risk arises from the duration mismatch between assets and liabilities in relation to traditional individual and group life contracts, although ASR is working to reduce this risk through longer duration assets and the use of swaps and swaptions.

Liquidity: Consistently Strong

Liquidity is strong thanks to underwriting cash flows exceeding 110% over the past three years and the proportion of investments in the form of cash maintained at 3%. The relatively high proportion of total invested assets in mortgages, loans, private investments, property (26% of nonlinked investments) and structured investments, and bank hybrid instruments somewhat constrains the balance-sheet liquidity. However, liquid assets represent the bulk of investments (62%) and 70% of gross technical liabilities at year-end 2008.

Capitalization: Hampered By Adverse Investment Performance

We view capitalization as strong due to prudent reserving and investment hedging strategies in place, although risk-based capital adequacy is only good owing to the current depressed state of investment markets. The volatility of the total adjusted capital acts as an offsetting factor, however, due to the significant contribution of unrealized capital gains on property and present value of future profits.

Capital adequacy

Capital adequacy is good at year-end 2008 based on our risk-based capital model. Although lower than the level implied by the current ratings, we expect ASR's earnings retention capacity to bring its capital adequacy closer to a level consistent with its current ratings over the next two years, although the depressed state of investment markets could prevent this. In addition, ASR makes significant use of hedging instruments to mitigate the volatility emanating from equity market and interest rate movements.

Quality of capital

Quality of capital exposes the capital base to high volatility from investment market conditions. ASR shareholders' equity is relatively small (€432 million), compared with the risk-adjusted target capital. This was exacerbated by a €1 billion dividend upstream to Fortis Group in 2007. A significant proportion of the total adjusted capital is made up of relatively volatile components, such as present value of future profits and unrealized capital gains. Outstanding hybrid debt is also important as it represents 150% of IFRS shareholders' equity.

Reserving

Reserving at ASR is conservative as a result of a policy of reserving in excess of the 95th percentile on an undiscounted basis.

Reinsurance

Reinsurance utilization at ASR is low owing to the short-tail nature of its P/C business and the importance of A&H business. The reinsurance program provides suitable levels of cover, with a panel of highly rated reinsurers (more than 96% of reinsurers on the panel are rated 'A' or higher).

Financial Flexibility: Minimal Capital Requirements In The Medium Term

Table 3

ASR Group/Financial Statistics

(Mil. €)	2008	2007	2006
Total assets	36,191	38,399	39,459
Total adjusted equity	529	2404	3310
Change in adjusted equity (%)	(78.0)	(27.4)	29.9

Financial flexibility is strong, driven by the minimal requirement for additional external funding and limited capital needs to fund organic business growth and to support its capital adequacy.

Despite the current dislocation in the capital markets, ASR recently proved its ability to manage its funding sources, as it achieved an 85% acceptance rate for the exchange program announced in relation to its €650 million hybrid debt which it replaced with a new issue. However, in our view, most of the sources of financial flexibility available to ASR lie within its earnings generation and retention capacity. We view the government ownership as a limited positive factor in that regard, as we expect the government to limit its supportive funding to ensure ASR's solvency does not fall below the minimum regulatory requirement. We expect government ownership to favor earnings retention at ASR, however, in keeping with its publicly stated intention of helping to return ASR to the private sector in a financially viable state.

Ratings Detail (As Of August 19, 2009)*	
Operating Companies Covered By This Report	
ASR Levensverzekering N.V.	
Financial Strength Rating	
Local Currency	A/Negative/--
Counterparty Credit Rating	
Local Currency	A/Negative/--
Junior Subordinated (1 Issue)	BBB
Junior Subordinated (1 Issue)	BBB+
ASR Schadeverzekering N.V.	
Financial Strength Rating	
Local Currency	A/Negative/--
Issuer Credit Rating	
Local Currency	A/Negative/--
Domicile	Netherlands

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

Additional Contact:
Insurance Ratings Europe; InsuranceInteractive_Europe@standardandpoors.com

Additional Contact:
Insurance Ratings Europe; InsuranceInteractive_Europe@standardandpoors.com